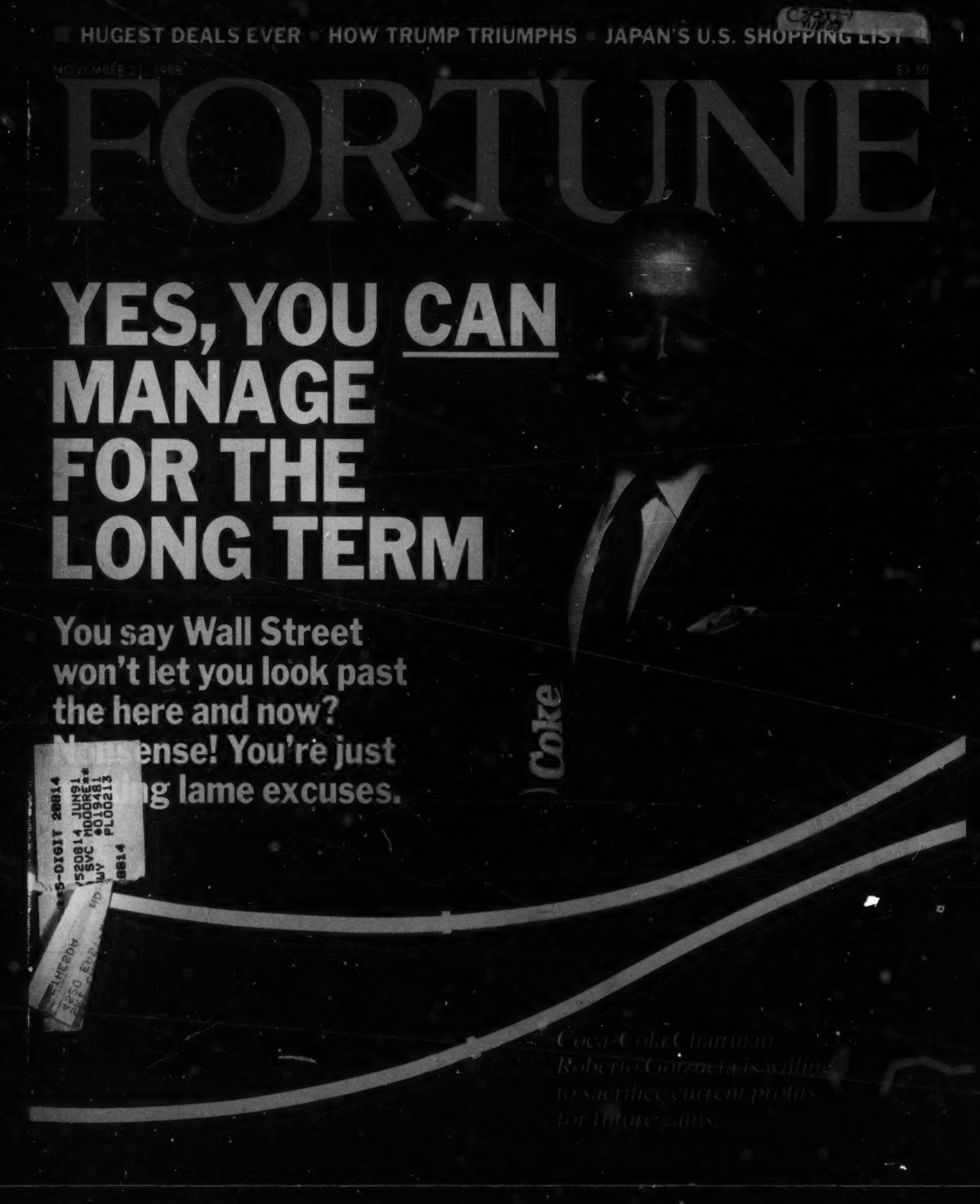
HUGEST DEALS EVER • HOW TRUMP TRIUMPHS • JAPAN'S U.S. SHOPPING LIST

NOVEMBER 21, 1988 $3.50

FORTUNE

YES, YOU CAN MANAGE FOR THE LONG TERM

You say Wall Street won't let you look past the here and now? Nonsense! You're just ...ng lame excuses.



Coca-Cola Chairman Roberto Goizueta is willing to sacrifice current profits for future gains.

NOVEMBER 21, 1988

FORTUNE

ROB NELSON—PICTURE GROUP

COVER: Gregory Heisler photographed Coca-Cola Chairman Roberto Goizueta at the company's headquarters in Atlanta.

Coke's *long-term* future is a more powerful force in driving the stock up than its near-term profits.
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Executives complain that Wall Street won't let them look past the here and now. But they're just making lame excuses. The truth is the opposite: Investors love the future.
by Gary Hector

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"We hope [the Japanese] will learn how to express their inner emotions—without the aid of a calculator."

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"It's not to the benefit of the shareholders. Kraft has good quality earnings but so do Treasury bills."

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"I think investors will be much more optimistic if Bush is elected."

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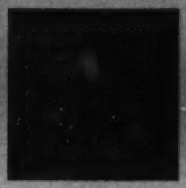

"The First Law of Garbage is [that] everybody wants you to pick it up, and nobody wants you to put it down."

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"Other people are schmucks. I am not a schmuck."

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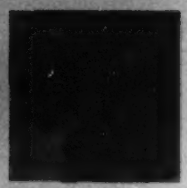

"Hispanics may *choose* not to assimilate, but not because they *cannot*."

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No, but he's trying. His business holdings could already be worth over $2 billion. An inside look at his operations reveals how he does it: Key elements include shrewd use of copious debt and astonishing chutzpah. *by Monci Jo Williams*

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EDITOR'S DESK

TOM ZAD ANDREW

Gary Hector with his acclaimed new book

YOU HEAR the complaint all the time: America's financial markets are so relentless in demanding short-term performance that they're strangling innovation, vision, anything that doesn't pay off right now. It's not just a problem, some executives say—it's the worst problem facing U.S. business.

That is a charge worth investigating, and what better person for the job than associate editor Gary Hector? He had just finished writing our recent article on how the stock market digests information and sets values. In this issue, Hector's examination of the short-term mania theory, conducted with reporter Wilton Woods, is the cover story (page 64). To report it, Hector visited companies in Chicago, Pittsburgh, and Los Angeles. His well-documented conclusion: Contrary to popular wisdom, investors look remarkably far into the future and are generally willing to indulge a company's gutsy moves if the long term looks promising.

Hector's career is in high gear. Besides writing for FORTUNE, he is criss-crossing the country promoting his book *Breaking the Bank* (Little Brown, $18.95). Critics have unanimously praised this fascinating tale of the collapse of BankAmerica, once the world's largest and most profitable bank. The *Wall Street Journal* called the book a "richly detailed, brisk, and colorful account that should be required reading for the high and mighty of American business and industry." FORTUNE readers enjoyed an early excerpt in the issue of June 6, 1988.

Since becoming a journalist 12 years ago, Hector has often distinguished himself. He won the prestigious Gerald Loeb Award for a series on Chrysler's debt renegotiations when he wrote for *American Banker*. In six years at FORTUNE, he has written a cover story on Citicorp, a profile of J.P. Morgan & Co., and two BankAmerica articles, among many others. Hector says he was fascinated for some time by the inaction of the bank's directors. "FORTUNE was asking in 1985 if Samuel Armacost, then chief executive, was the right man to head the bank," recalls Hector. "The board did not get around to asking that question until 1986."

Early covers: KKR and Ross Johnson

FORTUNE readers were especially well prepared to assess the new battle over RJR Nabisco, which could yield the biggest deal ever. The principals—RJR Nabisco chief Ross Johnson and KKR, the leveraged-buyout firm—were subjects of successive cover stories. Carol J. Loomis's intimate examination of the secretive KKR in our July 4 issue revealed the astonishing fact that the firm commanded $40 billion, enough to buy two Texacos. Bill Saporito's profile of Johnson in the July 18 issue explained why Johnson is known as an "ultimate corporate master blaster." Those observations resonate in today's headlines and in Saporito's own look at the duel—as well as at Philip Morris's bid for Kraft—beginning on page 81.

Managing Editor

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The Business Council's members include diehards who are opposed to *any* increase. As an ally they have the Coalition for Fiscal Restraint, whose corporate members include **Sears**, **Armstrong**, and **Amway**. Michael Monroney, the group's chairman, hopes that tax-prone corporate chiefs will soon come back to the resisters' fold. "We will be talking to some bell cows now," he says.

Other chairmen and chief executives who still feel that a tax increase is unnecessary held out some of the ways they'd go if pushed against the wall. Among their proposals:

- Tax what people spend, not what they earn, says Ruben Mettler of **TRW**.
- Increase excise and consumption taxes on liquor, tobacco, and gasoline, says Paul Oreffice of **Dow Chemical**.
- Introduce a value-added tax, say George Keller of **Chevron** and David Roderick of **USX**.
- Raise the gasoline tax 25 cents per gallon, says John Reed of **Citicorp**.

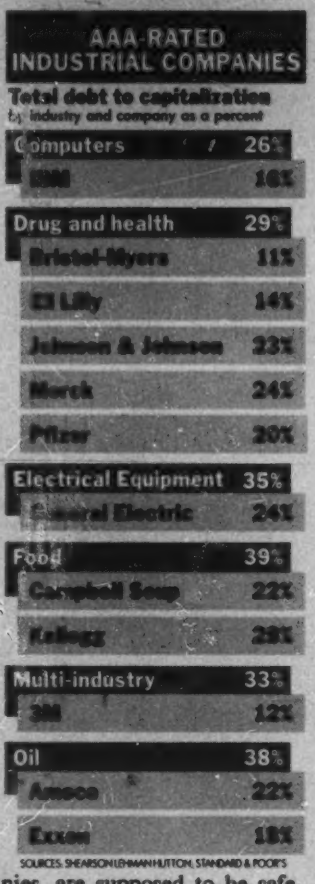
Trade associations are already priming their lobbyists to look out for their special interests when Congress convenes January 3, and are forming new and sometimes surprising alliances in the process.

Opposing Reed's gasoline tax proposal are both the American Automobile Association and the American Trucking Associations (traditionally in philosophical gridlock over who should be on the roads). Even Big Oil's American Petroleum Institute and the smaller producers' Independent Petroleum Association of America, often at loggerheads, find themselves on the same side. Both hate the idea of additional gas taxes. – **Cynthia Hutton**

THE STRAIGHT-A CLUB

■ As everyone knows, Groucho Marx is credited with sneering, "I wouldn't want to belong to any club that would accept me as a member."

Some blue-chip corporations seem to have the same attitude. The members of the AAA club have earned their exclusive credit ratings from Standard & Poor's because their bonds, and their companies, are supposed to be safe. But with record-setting deals for such giants as Kraft and RJR Nabisco in the works (see Money & Markets), even AAA companies are at risk. In fact, in this era of fashionable debt, high leverage, and hostile takeover (known euphemistically on Wall Street as "event risk"), AAA bonds may be chancier than most. Says Zane Brown, head of the bond department at **Equitable Capital**: "With a AAA, there's a heck of a lot more event risk than there is with a BBB," the lowest investment grade.



In 1980 the straight-A club had 26 members, mainly in such recession-proof industries as oil, drugs, and food. But takeovers and the ongoing borrowing binge have reduced the list to today's surviving 12 (see table).

For example, as management began a leveraged buyout of **Fort Howard** this year, the paper company's AAA bonds tumbled to BB–. The shareholders profited, while the bondholders saw their investments slide under the weight of all the added debt. Says Richard Wilson, a fixed-income analyst with **Merrill Lynch**: "Takeovers help the shareholders and screw the bondholders."

Increasingly, AAA status costs the company more than a less exalted rating. For one thing, heavy debt often brings with it hefty tax deductions.

In addition, the AAA rating can sometimes mean a lower stock price because the company may appear to be stodgily run. This, in turn, makes a company more vulnerable to takeover. That's what happened this year to AAA-rated **Sterling Drug**, whose stock was undervalued. **Hoffmann-La Roche** launched a hostile bid, and Sterling was driven into the arms of **Kodak**.

S&P executive director Leo O'Neill says he expects more resignations from the club. Some of them will be voluntary, he predicts, and others involuntary. – **William E. Sheeline**

CHRIS CORCORAN

Japan now imports humor.

SEND IN THE CLOWNS

■ Aside from their end-of-the-day drinkathons when they can—and often *do*—let down their reserve, Japan's dedicated blue-suited managers tend to be as stiff as planks. To loosen them up, **Ringling Bros. and Barnum & Bailey Circus** is opening a college for clowns in Tokyo next September.

The students—salary men, waiters, store clerks, and others in the service industries—will learn stilt walking and other circus antics. But their majors will be improvisation and pantomime. Thus, says Ringling Bros. President Kenneth Feld, "the businessmen will lose their inhibitions and learn how to relate with foreigners."

The clown school will be operated under license by **Naturally Yours**, a Japanese health food company that wants to diversify. The first freshman class will have about 30 students. Their tuition fees have yet to be decided.

CEOs VIEW LIFE AFTER THE ELECTION

America's leading corporate chiefs say that with a Bush victory, they expect rising stocks and business expansion. Among this group, Dukakis never stood a chance. ■ *by Faye Rice*

THE CHIEFS of America's largest corporations have formed their recent business outlook on the assumption that George Bush will become President. On the eve of the election they looked forward eagerly to the business conditions they expect to prevail under a Bush Administration and discussed specific actions they might take—actions that would mostly mean good news for the economy. The prospect of a Dukakis victory practically chilled their spines. The CEOs figured investors will see things much as they do; by their estimate, a Bush victory rather than a Dukakis win would be worth 200 extra points on the Dow Jones industrial average by year-end.

These are among the results of the latest FORTUNE 500/CNN Moneyline CEO poll. The independent opinion research firm Clark Martire & Bartolomeo conducted the survey between October 12 and October 21, questioning 234 CEOs from FORTUNE 500 and FORTUNE Service 500 companies.

Polls extending back to last winter have shown that a solid majority of America's top CEOs favor Bush. But while 90% believed last February that the Republican nominee, whoever he might be, would win in November, that expectation wilted during the summer after the Democrats nominated Dukakis and Bush's nomination by the Republicans was assured. By mid-October, however, 89% of the CEOs polled had decided that a Bush win would not change the immediate outlook for their businesses, indicating a strong presumption that he would prevail.

Why were they so gung-ho for Bush? Answers emerge in some of the poll's most striking results. When asked under which President they would be more likely to expand their businesses, 62% chose Bush. Exactly one respondent, representing less than half of 1% of the total, chose Dukakis. Observes J. Landis Martin of NL Industries: "With Bush we have the security that governmental regulations won't increase during the next three years, so the cost of expansion won't be too high." A sizable minority of CEOs (33%) felt the outcome of the election would not influence their plans to expand. "We won't change our strategy no matter who is President," says Fuqua Industries' J. B. Fuqua, one of the few Democrats among the CEOs. David Hinson of Midway Airlines says, "We'll just keep running a good airline regardless of politics."

"I think investors will be much more optimistic if Bush is elected."

J. LANDIS MARTIN
NL Industries

Almost as impressively, 51% of the chiefs said they would more likely increase capital spending under Bush, while only a single respondent said he would under Dukakis. In the CEOs' view Bush is also far better news for job creation. Although Dukakis made "good jobs at good wages" one of his principal campaign themes, only 1% of the CEOs said they would be more likely to increase their work force under Dukakis than they would under Bush; 49% said Bush would more likely mean more jobs at their companies, and another 49% said the election's outcome wouldn't affect their hiring plans. Most said the election would not influence their plans to borrow money or adjust inventories.

A few CEOs believe Bush would benefit their industries specifically. Martin's NL Industries includes a drilling services oper-

REPORTER ASSOCIATE *Jonas Bernard Blank*

Q **Would the election of George Bush significantly change your outlook for your business?**

A

Yes	11%
No	89%
Not sure	–

Q **Would the election of Michael Dukakis significantly change your outlook for your business?**

A

Yes	66%
No	31%
Not sure	3%

Q **Would you be more likely to [take the following steps] with Bush as President or with Dukakis as President?**

A

	Bush	Dukakis	No difference	Not sure
Expand your business	62%	*	33%	5%
Increase capital spending	51%	*	43%	6%
Increase your work force	49%	1%	49%	1%
Increase borrowing	32%	2%	58%	8%
Increase inventories	23%	*	58%	19%

* Less than 1%.

ation, and he says, "We think there is a good chance for a tax incentive to drill for natural gas or oil, which means our profits would continue to improve." That would be especially good news, considering that drilling services at NL have lost $700 million over the past six years and are just breaking into the black this year. E. B.

"Dukakis is less interested in the welfare of corporations."

E. B. LEISENRING
Westmoreland Coal

NICK KELSH

Leisenring Jr. of Westmoreland Coal expects Bush to boost his business too. "Bush will sign into law a cost-effective clean air act that Reagan was not in favor of," he says. "This could encourage utilities to switch from high- to low-sulfur coal, which will be favorable to my company."

The CEOs believe that Wall Street is pro-Bush as well. The median of their forecasts equates a Bush victory with a slightly rising Dow; they predicted a close of 2200 at year-end, vs. 2140 when FORTUNE went to press. Their median forecast based on a Dukakis win was a decline to 2000. Looking beyond the medians at the full range of forecasts shows a more dramatic result: Only one CEO thought the Dow would close below 2000 at year-end if Bush were elected, while 27% thought it would close above 2200; when the CEOs were asked to imagine a Dukakis victory, the figures were almost precisely reversed.

The CEOs were so confident of their candidate's abilities that, when asked what they feared most about a Bush Administration, their most common answer was "nothing." Among those who cited specific concerns, the most prevalent was a worry that Bush wouldn't or couldn't effectively deal with the economy's No. 1 problem, the budget deficit. "Can he make the tough decisions on expenditure cuts so that the budget deficit can be reduced significantly?" asks Kenneth Lay of Enron, a Houston-based natural gas utility.

Others worried that Bush would not be able to work with a Democratic Congress. Says John B. Smith of Mayflower Group, an Indiana transportation company: "I fear that with a Republican President and a Democratic Congress we'll just float along, and the real problems—the budget and trade deficits—won't be addressed." Roughly the same number of chiefs were concerned about something happening to Bush—and Quayle becoming President. Harry Bubb of Pacific Mutual Life speaks for many when he says, "Quayle is scary."

The general question of Bush's leadership and vision disturbed almost as many CEOs. Edwin Lupberger of Middle South Utilities worries that "we might end up with a stalemate between the congressional and executive branches due to his lack of leadership. Reagan had an ability to articulate and communicate his programs that Bush doesn't seem to have."

All these fears amount to little compared with what the CEOs thought would happen in a Dukakis Administration. Nearly all the leaders surveyed expressed some sort of concern about the Massachusetts governor's moving to the White House. Perhaps it's to be expected, but they worried most that he would do just what George Bush said he would: tax and spend. Richard P. Wollenberg expresses a widely held view when he says, "I fear a burgeoning welfare state." Jess Hay of Lomas Financial had doubts about whether "his tax policy would be one that encourages savings, capital formation, and entrepreneurship."

Many chief executives considered Dukakis just plain antibusiness. His long connection with Harvard certainly won him no points with this group. "I fear the selection of academic advisers rather than business advisers," says John D. Nichols of Illinois Tool Works. W.R. Grace's J. Peter Grace gripes, "He'd bring down a group of Harvard professors with new ideas not really tried or proven." Several CEOs believed that Dukakis's agenda would include increased government regulation of business. "I fear that heavy government bureaucracy will return again, with all things that flow from that," says Robert Luciano of Schering-Plough.

"If Bush has to raise taxes, I won't mind. I think it is the only way to close the deficit."

J. B. FUQUA
Fuqua Industries

Q A What do you fear most about a Bush Administration?

Nothing	37%
No progress on deficit	21%
Impasse with Congress	9%
Quayle as President	9%
Lack of leadership	8%
Higher taxes	5%

Q A What do you fear most about a Dukakis Administration?

Higher taxes	38%
Higher spending	18%
More regulations	14%
Lack of experience	12%
Inflation	9%
No progress on deficit	8%

Q A Where would you expect the Dow Jones industrial average to close on December 30, 1988, if Bush is elected? If Dukakis is elected?

Bush (median)	2200
Dukakis (median)	2000

Many cited Dukakis's lack of experience on the national and world scenes. The CEOs believed Dukakis especially weak in international affairs. Observed Peter L. Scott of Emhart: "He has a complete lack of understanding of international negotiations and the problems we have, particularly with the Russians." Frank Wobst of Huntington Bancshares would fear "a somewhat more amateurish approach to our foreign policy." Other leaders surveyed thought Dukakis would induce inflation. Why? Says Edward B. Brandon: "He lacks the ability to control spending, and we'll have to inflate the economy to take care of that."

As the U.S. economy enters its seventh year of uninterrupted expansion, American CEOs could hardly be expected to want to rock the boat. Ultimately, that seems to be why they were such enthusiastic fans of Bush. Says T. Neal Combs of Fruehauf, a Detroit auto parts manufacturer: "The Bush Administration will represent the status quo—slow, steady growth. And that's a very good thing for business." ■

HERE COMES THE BIG NEW CLEANUP

Stunned by evidence of ecological damage, Americans are again declaring war on pollution. It calls for fresh, market-oriented approaches, not the old rigid regulations. ■ *by Jeremy Main*

THE SUMMER OF 1988 will be remembered as the time "the earth spoke back," in the words of one of George Bush's speech writers. The heat and drought, the fouled beaches and burning forests, all seemed to chide us for turning the green earth brown. Since both presidential candidates discovered the environment as an issue and Congress is being prodded by angry voters, a burst of new laws and regulations can be expected under the next Administration. The question is whether we will get the right solutions to the right problems.

Heightened concern about the environment is justified. Scientists have detected increasing evidence that chlorofluorocarbons and other chemicals are rising to the stratosphere and eating the ozone layer, which protects life from cancer-causing ultraviolet rays. Carbon dioxide and other gases have accumulated over decades of Industrial Age combustion and threaten to raise the earth's temperature through the greenhouse effect.

Little wonder that the environmental movement has swelled in the Eighties, some organizations more than doubling their membership. A coalition of 18 major groups is preparing a "green blueprint" of policies to present to the new President and each of his Cabinet members. The next Administration will immediately confront major issues—acid rain, ozone at ground level and the lack of it in the stratosphere, radon, a further cleanup of PCBs, polluted groundwater, lead in drinking water, and possible environmental damage from oil exploration in the Arctic National Wildlife Refuge.

So serious are some of the dangers that many environmentalists are calling for a "third wave" of attacks on ecological problems. The first wave came at the turn of the century and was symbolized by Teddy Roosevelt's efforts to save the wilderness. The second arrived in 1962 with the publication of Rachel Carson's *Silent Spring*, about the effects of pesticides. Riding this wave, the legislation of the Sixties and Seventies went after highly conspicuous sources of pollution in the air, water, and ground with a mass of regulations, requirements, deadlines, and penalties. The cost has been high—about $78 billion a year lately—but the movement has won major victories. The pesticide DDT is banned, Lake Erie has come back to life, some 216,000 miles of polluted rivers are swimmable and fishable once more, airborne lead is almost gone, and some other major air pollutants have been reduced significantly.

The third-wave attack demands a fresh, third-wave approach that learns from the errors of the past. Congress has been inclined to saddle the nation with laws that are expensive, prone to regulatory and legal hassles, tied to unrealistic goals, and locked into the wrong technologies. The burst of crowd-pleasing legislation passed just before the elections illustrated Congress's old bad habits—bills to control medical wastes, ban the dumping of sewage sludge in the oceans, renew the Endangered Species Act, and impose new restrictions on pesticides.

With a more commonsense, market-oriented strategy, the U.S. could get on with the cleanup without drowning the economy in unnecessary regulation and expense. William D. Ruckelshaus, head of the Environmental Protection Agency in the Nixon and Reagan Administrations, says the U.S. has taken the "command

THE PROGRESS TO DATE

AIR POLLUTION

Change in emissions 1970–86

■ Particulates	down 64%
■ Carbon monoxide	down 38%
■ Volatile organic compounds	down 29%
■ Sulfur oxides	down 25%
■ Nitrogen oxides	up 6%

WATER POLLUTION

Change since early 1970s

■ Ocean dumping of industrial waste	down 94%
■ Cities without adequate sewage treatment	down 80%
■ Miles of river unfit for swimming	down 44%
■ Ocean dumping of sewage sludge	up 60%

SOURCES: ENVIRONMENTAL PROTECTION AGENCY; ASSOC. OF STATE AND INTERSTATE WATER POLLUTION CONTROL ADMINISTRATORS

THE JOB AHEAD: DO'S & DON'TS

Acid rain: Keep reducing sulfur oxides gradually; avoid expensive new clampdown until evidence justifies it.

Ground-level ozone: Put new curbs on gas stations and other small sources; avoid drastic new restrictions on auto emissions.

Global warming: Continue using fossil fuels more efficiently; encourage nuclear power.

Water pollution: Speed construction of sewage treatment plants.

Toxic waste: Use incentives to reduce volume.

Garbage: Step up recycling; burn or bury the rest under strict controls.

and control" approach about as far as it can go. Ruckelshaus, who now heads the country's second-largest waste disposal company, Browning-Ferris Industries, favors greater use of economic incentives wherever appropriate.

So do two Senators who resist the congressional rush to regulate: Timothy Wirth, a Colorado Democrat, and John Heinz, a Pennsylvania Republican. In a newly released report they sponsored, they urge that the U.S. harness market forces "by providing incentives for businesses and individuals to go beyond what regulators can require." The two Senators recommend an array of tradable credits and permits, taxes, swaps, refunds, and deposits to tackle 16 major environmental problems.

Some of these ideas have been around for years. Since 1979, EPA regulations have permitted the trading of emission credits within an imaginary "bubble" over an industrial area. Credits earned in one place where a company cleans up more than the law requires can be applied to another place where permissible pollution levels are being exceeded. A corporation may trade the right to pollute among its own divisions or with another company. Armco, Du Pont, USX, and 3M have traded air pollution credits, and a small market for them has developed. But Congress has been cool to the whole idea and turned down a proposal to tax sulfur dioxide emissions to spur a cleanup of the electric power industry's coal-burning plants. While economists argued that the tax was the most cost-effective method of cutting emissions, environmentalists branded it a license to pollute.

GEORGE STEVENS

The Cuyahoga River in Cleveland, blackened in 1965 by discharges from a steel plant (above), was once so polluted it caught fire. Cleaned up, it now invites outdoor diners.

Today an increasingly sophisticated and diverse environmental movement sees an advantage in using incentives. Frederic

Despite a general improvement in air quality, smoggy days bedevil Denver, one of 76 cities that recently missed a federal deadline to cut ozone and carbon monoxide readings.

Krupp, executive director of the Environmental Defense Fund, an adviser on the Heinz-Wirth report, sees "a lot of room for creative approaches that put the economic signals where they should be." When it comes to methods, Krupp sounds amazingly like Harvey Alter, a chemist who is an environmental spokesman for the U.S. Chamber of Commerce. "Instead of giving people a lot of regulations and forms," says Alter, "give them goals and let them figure out how to get there. Congress has the mistaken belief that you have to beat on people to get anything done."

Here is a rundown on the nation's leading environmental issues and how they should be attacked:

ACID RAIN

Lamentably, Congress shows no inclination to apply common sense to acid rain. Sulfur oxides, largely from coal-burning utilities in the Midwest, have been blamed for acid rain, which falls mostly in the East and in Canada. Scientists are still debating how much damage it is doing to trees and to lake and river life, and some see no emergency. A recent EPA study of 500 streams in the East found that 2.7% of their combined lengths was acidic. An interim report from the ten-year, $500 million National Acid Precipitation Assessment Program, which will complete its work in two years, says that acidity seems not to be getting worse.

Proof of damage to forests turns out to be elusive. The death of trees in southern Appalachia was first attributed to acid rain. Now investigators blame it on an insect, the balsam woolly adelgid, though they think acid rain and ground-level ozone may have made the trees more vulnerable. If any business interest should be concerned about identifying acid rain damage, it is the paper industry. Yet Champion International and International Paper report no damage to forests they own in areas where the rain falls. The problem, in short, seems worrisome though not alarming.

But Congress has stopped listening. Even conservative lawmakers are persuaded that the country wants action now. Newt Gingrich, a young Republican Congressman from Georgia, says, "There's no question acid rain is a problem. Industry has lost that battle and is foolish to continue to fight it." Many members of Congress are itching to require utilities, mostly in the Midwest, to spend billions installing and running scrubbers to remove the offending sulfur dioxide. No matter that better, cheaper, clean coal-burning technologies are within reach. No matter that a major coal plant cleanup is already under way.

Under the 1977 amendments to the Clean Air Act, scrubbers have been installed in 146 new generating units, and many older plants have switched to burning low-sulfur coal. As a result total sulfur oxides have dropped by 21%, even though the use of coal to generate electric power is up 44%. *With no new laws*, emissions will keep falling as modern plants come on line and old ones are scrapped. It surely makes sense to keep the emissions heading downward until more evidence is in. But Congress's get-tough faction wants a bill that would compel quick action to cut sulfur dioxide far more drastically—by half within a decade or so. That would require the costly shoehorning of scrubbers into scores of old plants.

MANDATING SCRUBBERS is an expensive, technically inferior solution. For every ton of sulfur they keep out of the smokestack by spraying furnace gases with a slurry of limestone and water, scrubbers produce two to seven tons of useless sludge that has to be dumped somewhere. Just to operate a scrubber consumes 3% to 5% of the generating plant's energy.

Depending on the final form of the law Congress passes, the utilities would have to spend somewhere between $3.5 billion and $8 billion a year building and running scrubbers. This may be good news for Babcock & Wilcox, Combustion Engineering, Foster Wheeler, and other companies that supply the equipment, but not for utilities and their customers. American Electric Power, the biggest utility affected, claims that unless the costs are

REPORTER ASSOCIATE *Patricia A. Langan*

shared by other parts of the country, AEP's residential rates would increase 23% and industrial rates as much as 50%—enough to drive marginal customers out of business.

A third-wave solution for acid rain would not oblige utilities and other polluters to install scrubbers, but leave them free to choose the most effective and economic ways to meet air-quality standards. For example, with "acid rain credits" proposed by the Heinz-Wirth report, a utility wouldn't be forced to waste money grafting a scrubber onto an old plant. Instead, it could let the old plant live out its life undisturbed, earning the necessary credits to keep it going by reducing emissions more economically in a new plant, or buying the credits from another company that had clamped down on sulfur dioxide.

If a cleanup were necessary, a utility could use whatever technology seemed best for the job—scrubbers, fluidized-bed, coal gasification, or other methods developed by 16 companies that are receiving $537 million in grants this year from the Department of Energy. The companies are contributing $810 million of their own. Willis S. White Jr., AEP's chairman, says his company will start up a clean-burning demonstration plant in 1990 and can have a full-scale facility operating by 1995. Both will use a "pressurized fluidized-bed" system that burns coal suspended in blowing air and mixed with crushed limestone. The result is a cleaner-burning and more efficient plant. While conventional coal facilities convert only 35% of coal to electricity, fluidized-bed plants can achieve efficiencies of 38% to 40%.

OZONE

This form of oxygen plays a beneficial role in the stratosphere, shielding life from the ultraviolet rays of the sun. The Senate has ratified an international treaty committing industrial countries to a 50% reduction in the use of ozone-depleting chlorofluorocarbons by 1998. The problem may be worsening, and the EPA recently recommended a total phase-out—probably a good move. CFCs are used in refrigerants, air conditioners, and foam plastic insulation. While substitutes are already being found, they need to be tested for cost and effectiveness.

Ozone at ground level is a different story, an environmental bad guy. Here Congress is in a mood to move rashly, with unrealistic new rules.

When sunlight and heat react with gasoline fumes and other volatile organic compounds, ozone forms. If the air is stagnant, as it was during last summer's heat wave, smog hangs close to the ground and ozone readings rocket. Ozone can temporarily cause coughs and chest pains even among healthy people, and long-term exposure is suspected of causing permanent damage to the lining of the lungs, but the evidence is still inconclusive.

The 1977 Clean Air Act set unrealistic deadlines for cleaning up ground-level ozone, thereby laying the groundwork for political farce. Despite general improve-

MR. CLEAN TALKS ABOUT PICKING UP THE GARBAGE

William D. Ruckelshaus, 56, has served as Mr. Clean in two Administrations. Under President Nixon he became the first head of the new Environmental Protection Agency in 1970. President Reagan called him back to set the EPA on its feet in 1983 after scandals at the top had destroyed its effectiveness and morale. Respected by many environmental activists as well as corporate executives, Ruckelshaus has been an environmental lawyer, consultant, and venture capitalist. He recently became chief executive of Browning-Ferris Industries of Houston, the second-largest waste disposal company in the U.S. In an interview he talked about the latest phase of the cleanup.

On beach pollution: Usually when environmental laws are passed as a result of a crisis, we end up with laws that are flawed. One reaction in the East has been to call a halt to ocean dumping of sludge, even though the sludge has nothing to do with the pollution on the beaches. If you don't dispose of the sludge at sea, you must bury it on land or burn it.

On finding waste burial sites: Every time recently we've tried to locate a place, we run into serious public resistance. People respond to the First Law of Garbage, which is everybody wants you to pick it up, and nobody wants you to put it down. But in the state of Washington, where a firm I was formerly with solicited bids from communities on the location of a hazardous-waste facility, eight have asked for continuing discussions. We told them we are in business to make a return and would share that with them.

On recycling: We can recycle a much higher percentage of household garbage than we now do, which is something like 10%.

On acid rain: I think the evidence of damage is strong enough that it makes sense to keep the levels of sulfur oxides and nitrogen oxides heading downward, as an insurance policy. You can do that at relatively modest cost. But if you're going to talk about bringing them down 50% with scrubbers, the cost is huge.

On the EPA: The environmentalists beat up on it. Congress beats up on it. The Administration usually ignores it. In a curious way, the strongest supporters of a forceful EPA are the industries it regulates. They want government to set reasonable standards, and they want the public to know they are being enforced.

Environmentalists had a suggestion when a New York garbage barge returned home loaded.

ment in air quality, most major U.S. urban areas are failing to meet the standards called for in the law. This can happen if readings at only one monitoring station in a metropolitan area exceed the EPA limit: 12 one-hundredths of a part per million for one hour a year three years in a row. After repeatedly postponing the Clean Air Act's date for compliance, Congress let it stand when the latest deadline came August 30.

SOME 100 URBAN AREAS are now violating the air standards, and the EPA is obliged by law to take action. In 14 cities with the worst violations, the agency plans to block any new industrial plants that would emit more than 100 tons of ozone-forming pollutants a year; that would rule out some fairly modest-size factories. But there's little incentive for anyone to comply with the targets, and the EPA's enforcement is likely to be halfhearted because the agency is short-handed, the targets are hard to attain, and in any case Congress could well come up with new goals.

Congress's proposed answer is to slap another round of restrictions on a highly visible source of ozone: the automobile. Bills that have been introduced would demand a slash in emissions of as much as 60% by the early 1990s. Pollution from cars, however, has already been reduced drastically. Today's new vehicles spew out 96% less hydrocarbons than their counterparts of the late 1960s, as well as 76% less nitrogen oxides and 96% less carbon monoxide. The contribution of all vehicles to ozone is now down to 29% of the total and will reach 20% by 1990, under the rules now in effect, as new cars replace old ones.

The auto industry claims, with some justification, that the technology does not exist to cut emissions as deeply as Congress is considering. But the emission of ozone-causing pollutants could be reduced at more reasonable cost by other provisions before Congress. The lawmakers or the EPA may require that gasoline be made less volatile to reduce evaporation, mandate fume-trapping sleeves on gas hoses and nozzles as California has done for years, and require autos to be equipped with carbon canisters to trap fumes during fueling. It would also make sense to crack down on ozone emanating from various other sources, such as solvent plants, paint shops, and small dry-cleaning establishments still exempt from present rules.

Special nozzles capture gas fumes in California and several cities elsewhere.

GLOBAL WARMING

The heat wave that gripped much of the U.S. last summer created new unease about the potentially biggest environmental threat of all: A blunt statement by Dr. James Hansen, director of the Goddard Institute for Space Studies in New York, that the earth's temperature is already rising because of the greenhouse effect had an electric effect on policymakers. Congress appropriated $43 million to study global warming, and Republican Senator Robert Stafford of Vermont, an environmental enthusiast who is retiring from Congress, put in a bill that would encourage the phase-out of electricity from fossil sources by the year 2050.

Some scientists feel Hansen is jumping the gun. It may have been hot in much of the U.S. last summer, but it was cold and wet in Europe, and much of South America had a colder-than-average winter. However a new EPA study reports a wide scientific consensus that sometime in the next century the earth's average temperature will rise between 1.8 and 3.6 degrees Fahrenheit. That's because as its economy expands, the world burns ever increasing amounts of fossil fuels, whose unavoidable byproduct, carbon dioxide, is considered the chief culprit in the greenhouse effect.

By trapping heat in the earth's atmosphere that would otherwise be radiated out to space, the accumulation of carbon dioxide, methane, and other gases will probably upset the careful balance of forces that makes the earth so hospitable to life. An increase of a few degrees could have drastic effects on ocean levels, rainfall, vegetation, agriculture, and our way of life. The global warming problem, says John Adams, executive director of the Natural Resources Defense Council, "overrides everything else. If we don't solve it, it doesn't matter what else we do."

Parts of the world are making progress in holding down fossil fuel consumption. Since 1973, when a steep rise in OPEC's oil price jolted Americans into insulating homes and buying fuel-efficient cars, U.S. energy use has barely increased, even though the economy has grown 45% in inflation-adjusted terms. West Germany and

Japan do even better: They use half as much energy per unit of GNP as the U.S. does. Further headway could be made if solar energy were substituted for fossil fuels, but for some time to come it will be too expensive for widespread use. Greater hope lies in convincing the public that nuclear power can be safe if new reactors are built using the latest fault-tolerant designs (FORTUNE, August 1). The persuasive process is beginning: Some environmentalists are coming around to the view that atomic power, which creates neither acid rain nor carbon dioxide, may have to be reconsidered.

The measures some politicians and environmentalists are talking about could change our way of life. During his presidential campaign, Michael Dukakis supported a 50-mile-per-gallon goal for automobiles. To get the average American into such a car would take an act of God rather than an act of Congress. His choice today would be restricted to a Honda Civic CRX HF or a midget GM import from Japan called the Geo Metro. The Heinz-Wirth report proposes a less draconian standard of 38 miles per gallon by the end of the century, vs. the average 26 mpg mandated by current law, to be realized through incentives rather than by fiat. Revenues from a tax on gas guzzlers would pay for rebates to purchasers of gas sippers. The idea is worth consideration.

Electric utilities, eager to avoid building expensive new generating plants, have already discovered the value of incentives. Southern California Edison contributes $50 to $75 to the cost of a refrigerator if it is at least 20% more efficient than California law requires and has given away 500,000 highly efficient light bulbs to low-income customers since the early 1980s. Panasonic and Philips of the Netherlands developed the energy-saving lamps, which are small fluorescent bulbs that screw into incandescent bulb sockets. They use only 15 watts, but glow as brightly as regular bulbs using 60 to 75 watts. They sell for $10 to $15 each, but last nine times as long or more.

To conserve energy—and battle global warming—Manuel Rocha of Los Angeles screws in a power-saving fluorescent light bulb.

SEWAGE

Fouled beaches aroused public indignation even more last summer than the weather. Congress reacted hastily by passing a bill on medical waste. It directs the EPA to set up yet another bureaucratic system for segregating, labeling, and tracking the stuff, with criminal and civil penalties for those who mess up the paperwork. In the final days, Congress also passed a bill banning the dumping of sewage sludge in the ocean by 1991.

Revolting though it was, the quantity of used hypodermic syringes and other medical throwaways that wound up on Eastern beaches was trivial. Charles Ehler, director of oceanography at the National Oceanic and Atmospheric Administration, sees medical waste as a "relatively benign environmental problem" and describes ocean dumping as "a very small contributor" to ocean pollution. Most of the sludge, dumped 106 miles off the coast of New York, disperses in the ocean. Little is known about its effects on sea creatures, but it may make them more susceptible to disease. The real marine pollution problem, Ehler says, is the runoff of agricultural chemicals, filth that washes off city streets, and particularly the discharge of insufficiently treated sewage.

In an infrastructure program second only to the interstate highway system in scope, the U.S. has spent $113 billion since 1972 to build and upgrade 15,000 sewage treatment plants. But many towns and cities lack adequate treatment facilities. Furthermore, older cities such as New York and Chicago have common storm and sanitary sewer lines. Heavy rains pour off the streets and temporarily overwhelm the sewage treatment plants. Hundreds of millions of gallons of untreated sewage pour into rivers and coastal waters, shutting down beaches and shellfish beds. During the Reagan Administration the construction of new treatment plants was slowed because of federal budget cuts. It should be accelerated again.

HAZARDOUS WASTES

U.S. policy on hazardous wastes illustrates how misguided the command and control approach can be. Superfund, the multibillion-dollar program to clean up toxic wastes from bygone years, has become so tied up in regulations and litigation that after eight years only 40 sites have been sanitized. It pays companies more to sue each other or the government over who should pay than to clean up. So far 1,175 sites have been identified as requiring immediate attention, and estimates of what the job will cost run from $100 billion to $500 billion. "There's mounting evidence that Superfund isn't working," says Joel Hirschhorn, the waste expert at the Office of Technology Assessment. The toxic waste cleanup doesn't lend itself to the incentive approach, but Hirschhorn and others think Superfund would show more results if the EPA were better manned and managed and more receptive to new technology.

THE NOXIOUS substances that industry brews today are better handled, for the laws are stricter on what can be poured into rivers or dumped somewhere else, and the economics of disposal make market-oriented solutions feasible. The sheer cost of getting rid of a ton of hazardous waste has climbed from $10 before legislation was passed in 1980 to as much as $500 today, when the stuff has to be incinerated or buried in double-lined landfills. These prices, plus growth in the solid-waste business, make it likely that Browning-Ferris and its main competitor, Waste Management of Oak Brook, Illinois, will continue to earn a return of better than 20% on shareholders' equity.

The expense also gives corporations an incentive to reduce or recycle wastes. For example, 3M, the most publicized practitioner of waste control, scrubs metal circuits with pumice instead of acids, thereby eliminating the need to get rid of 20 tons a year of nasty stuff.

continued

ENVIRONMENTAL ANXIETY GOES GLOBAL

Dead seals did for Europe's environmental awareness last summer what medical waste did in the U.S. After 12,000 of the creatures washed up along the coasts of the heavily polluted North Sea, voters spoke out in favor of tougher laws. Environment-conscious Swedes gave their radical Green Party nearly 6% of the popular vote in recent elections, sending 20 Greens to parliament for the first time. That's second only to the 44-strong Green faction in West Germany's lower house. In Japan, which launched an industrial cleanup in the 1970s, rising traffic and an economic boom have allowed pollution to rebound.

Europe will end shipboard burning of toxic wastes in the North Sea in 1994.

The most remarkable change in Europe has been the about-face of Britain's Margaret Thatcher. A few years ago the Iron Lady sternly denounced environmental pressure groups as "the enemy within." But in her first major speech on the subject after nine years in office, Thatcher recently called protecting the environment "one of the great challenges of the late 20th century." She identified acid rain, ozone depletion, and the greenhouse effect as major concerns.

Her words have already brought one big policy change. Last year, at an international conference in Montreal, Britons were among those who successfully blocked a proposed 80% reduction in ozone-destroying CFC emissions by 1999. Within days of Thatcher's speech, Lord Caithness, her environment minister, declared that Britain is now determined to slash CFC emissions by 85% "as soon as possible." Europe's environmental agenda for the 1990s presages a bigger spending rise, in relative terms, than the U.S. faces. No. 1 on the priority list is probably the North Sea. At a conference last year the countries that border its befouled waters pledged to cease all dumping of sewage sludge and the burning of toxic waste in ships like the one at left by the mid-1990s. West Germany's environment minister estimates that his country alone would need to spend $11 billion on the North Sea cleanup.

Next in urgency comes auto exhaust pollution. West Europeans have been slow to adopt catalytic converters, mandatory on new U.S. cars since the mid-1970s. Despite evidence that mounting car and truck traffic is defiling urban air, France recently scuttled an EEC plan that would have called for modest pollution controls on the small cars that account for about half the European market. Peugeot, a major French employer, convinced the government that such a rule would make its cars too expensive, costing sales and ultimately French jobs. By 1994, however, catalytic devices will be mandatory throughout the EEC for larger cars.

Just as Canada rails against sulfur oxides from the U.S., Scandinavia and other downwind countries point the finger at Britain. Last June the EEC's 12 members ended five years of wrangling and agreed on who should cut back and how much. Britain, West Europe's biggest contributor of sulfur oxides, will go beyond what is required in the U.S.: It will install scrubbers on old coal-burning power plants. Even the Germans, who already match the toughest U.S. standards, will have to spend heavily polishing their pristine performance. – **Richard I. Kirkland Jr.**

Where economics don't favor such practices, the incentives idea could be carried a step further. The Heinz-Wirth report favors a kind of deposit and refund system for hazardous wastes, akin to that used for beverage containers in many states. Industries that generated toxic substances could get a refund only if they returned them for proper burial or recycling.

ORDINARY GARBAGE

Municipal trash is piling up—literally. The U.S. produces twice as much per capita as any other country and puts 80% of it in landfills. Because it is increasingly difficult to find dump sites, the EPA has signaled a new approach: to reduce the volume of garbage that goes to landfills by 45% in four years, by incinerating 20% and recycling or otherwise keeping another 25% out of the waste stream. Environmentalists consider the recycling goal minimal, citing Japanese cities that handle twice as much of their wastes that way (FORTUNE, April 11).

Some places are ahead of the EPA's timetable. New Jersey, using the command approach, has ordered all its counties to submit plans to set aside 25% of their household and commercial trash for separate pickup and recycling. About one-quarter of the state's population already sorts its garbage.

Seattle is trying the carrot. Containers of recyclable cans, bottles, newspapers, and junk mail have been collected separately at no charge since February. But citizens have to pay $13.55 a month to have one can a week of ordinary garbage picked up, and $5 for each additional can. By fall, 55% of Seattle's households had begun separating recyclable trash to reduce charges, and the tonnage is exceeding expectations. Rather than dumping its sewage sludge in Puget Sound, as it used to, Seattle now sells it as a nutrient-rich commercial fertilizer.

■ Environmentalism began as a sort of counterculture movement in the 1960s, then was embraced more eagerly by the Democrats than by the Republicans. Now it may have become truly national and nonpartisan. Young voters, in particular, are displaying a much larger willingness to value and pay for clean air and clean water. Maybe, with luck, the country will also look for the cheapest, least burdensome ways of tackling its environmental problems. F

HOW JAPAN WILL SPEND ITS CASH

Talk about a shopping spree: Together the Japanese industrial giants have accumulated $60 billion and are itching to use it. Your company could be on their list. ■ *by Carla Rapoport*

PENCIL LOVERS, don't take a job at Toyota Motor Corp. The world's richest company—with $13.7 billion in spare cash—limits employees to one at a time. A sign over the towel dispenser in the restroom at headquarters reads: "Visitors Only." Matsushita Electric Industrial (Panasonic, National, among other brands), which has almost as much cash, has no towels at all in its restrooms. Statues of Pegasus and Michael Faraday in the Matsushita courtyard look like rejects from a Soviet collective. Need to make a phone call? Employees cheerfully wave you to pay phones in the lobby.

Welcome to the world of super-rich companies, Japanese style. With the rise in the yen and the export successes of the past 20 years, the Japanese now have the largest accumulation of corporate cash in the world. Out of 26 international companies with more than $1 billion in net cash and marketable securities, 19 are in Japan (see chart). Only three are American: Ford, Boeing, and IBM. Four are in Europe: Siemens, Daimler-Benz, and BASF in West Germany, and Volvo in Sweden.

Are the Japanese amassing a war chest or just setting new records for stinginess? Their Scrooge-like attention to costs made them rich in the first place. And it helps that shareholders in Japan have never been read their rights. But hey, guys, with more than $60 billion in net cash altogether, isn't it time to loosen up?

Surprisingly, the answer appears to be yes. You haven't seen a lot of action yet, but you will—and soon. In their plain-vanilla linoleum-floored boardrooms, directors are making plans for all that cash. Will the companies become even tougher competitors? As the Japanese say, *mochiron*, of course. Expect the following:

■ A big surge in overseas acquisitions. The Bridgestone-Firestone and Sony–CBS Records deals were just the beginning.

■ Rapid diversification. Sanyo Electric, whose sales lag behind more heavily leveraged competitors like NEC and Fujitsu, is moving into property development.

The first wave: Sony's Morita buys CBS Records.

■ Huge increases in research and development spending by those cash-rich companies that are not tops in their industries. Nippondenso, one of the largest international car-parts makers, has a list of product areas, from windshield wipers to alternators, where it aims to be No. 1 worldwide.

■ A fast erosion of classic Japanese consensus management. It's hard to spend large amounts of cash in a hurry if you have to get absolutely everybody on board first.

■ A big increase in corporate donations. If you run a charity, now could be the time to learn Japanese.

Of these fundamental changes, acquisitions in the West will be the most dramatic. Says Jun Imanishi, a 35-year-old managing director at Morgan Stanley Japan: "It's not just their cash, it's the amount of money these guys could borrow, which ranges from huge to unlimited. All of these companies, from our viewpoint, are serious mergers and acquisitions candidates, and we are talking to them—with no exceptions." Adds Tadashi Natori, a director and general manager of investment banking at the Industrial Bank of Japan: "They can't sit and sleep on their money anymore."

Should the West be worried? Probably not. The Japanese make good owners. They pay well for companies, they don't break them up, and they leave management intact. Yusho Yamamoto, head of corporate finance for Long-Term Credit Bank, Japan's current leader in mergers and acquisitions, says: "The Japanese look at the U.S. and see that companies are like balls being thrown around. No one tries to keep them and grow. The Japanese do." Adds W. Carl Kester, a Harvard business school professor: "I doubt there are many CEOs out there quaking in their boots about the Japanese. They're more worried about other Americans or Canadians or Germans or the English."

To get into the M&A game, Japanese companies have had to overhaul their corporate structures, not to mention their business philosophies. Says a leading Japanese banker, who asked not to be named: "Talking to these companies about spending their money was like shouting into the desert."

continued

REPORTER ASSOCIATE *Mark Alpert*

Investment bankers had no access point, no person to call, no one in charge of thinking about something other than cranking out widgets. In the past few months, however, new projects departments with decision-making powers have been sprouting like weeds. Last summer Toshiba set up a ten-person team to study acquisitions full time. Matsushita has two executive vice presidents who review ideas flooding in from the investment community. Says Mitsuo Goto, president of Nomura Wasserstein Perella, a new joint venture of Nomura Securities and Wasserstein Perella: "It used to be that 40 or 50 people had to know something before the president knew and before he would act. Everyone had to put his chop on the idea. Now corporate strategy people have a direct line to the top."

All the Japanese executives interviewed for this story insisted that they would never consider a hostile takeover of a company, foreign or domestic. Morgan Stanley's Imanishi isn't sure they can stick with that position indefinitely, but he agrees that the current mood is friendly, not fierce. Adds Jerome Corcoran, managing director of investment banking at Merrill Lynch Japan: "This whole list of cash-rich companies is driven to find strategic investments, not return on investment."

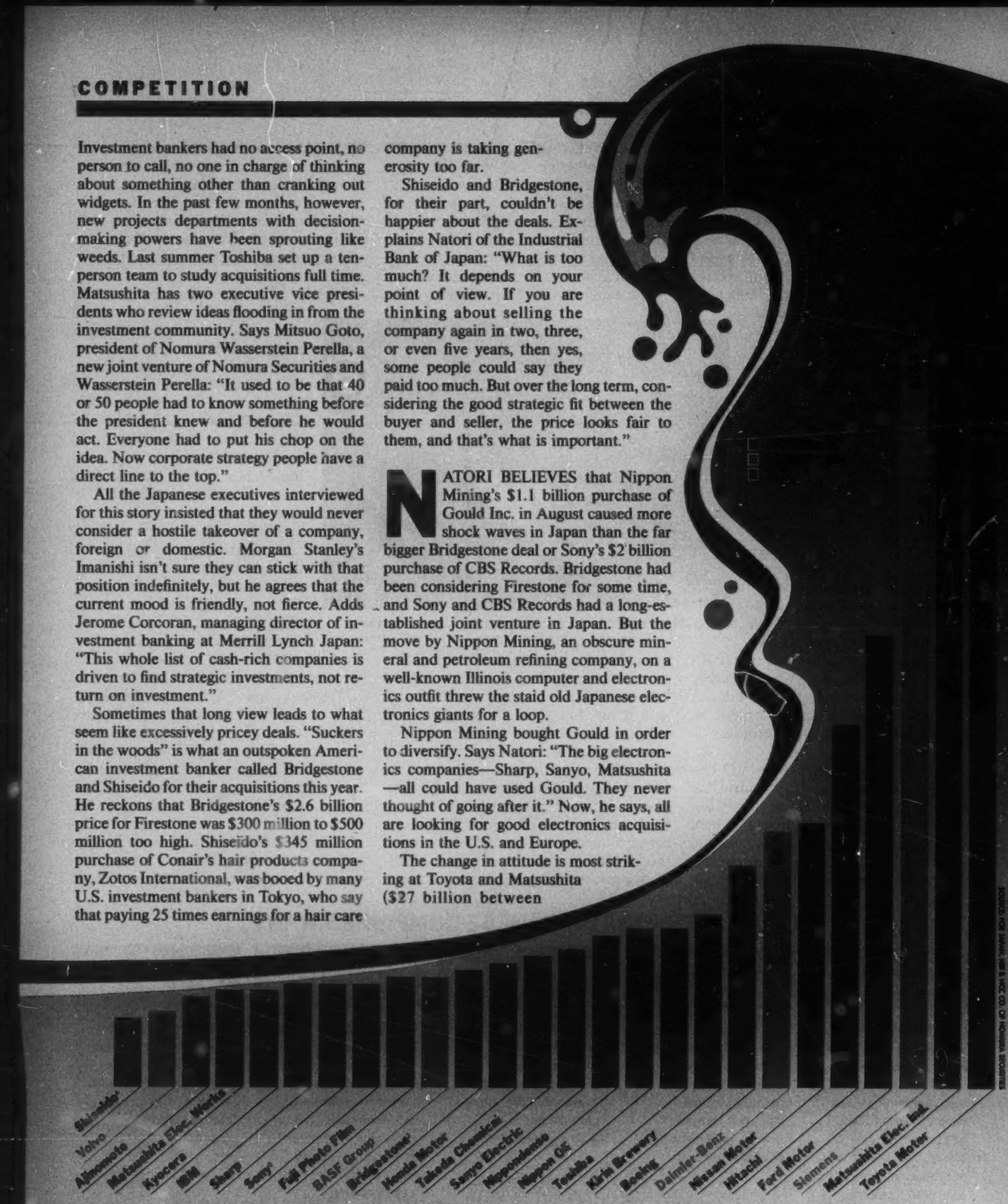
Sometimes that long view leads to what seem like excessively pricey deals. "Suckers in the woods" is what an outspoken American investment banker called Bridgestone and Shiseido for their acquisitions this year. He reckons that Bridgestone's $2.6 billion price for Firestone was $300 million to $500 million too high. Shiseido's $345 million purchase of Conair's hair products company, Zotos International, was booed by many U.S. investment bankers in Tokyo, who say that paying 25 times earnings for a hair care company is taking generosity too far.

Shiseido and Bridgestone, for their part, couldn't be happier about the deals. Explains Natori of the Industrial Bank of Japan: "What is too much? It depends on your point of view. If you are thinking about selling the company again in two, three, or even five years, then yes, some people could say they paid too much. But over the long term, considering the good strategic fit between the buyer and seller, the price looks fair to them, and that's what is important."

NATORI BELIEVES that Nippon Mining's $1.1 billion purchase of Gould Inc. in August caused more shock waves in Japan than the far bigger Bridgestone deal or Sony's $2 billion purchase of CBS Records. Bridgestone had been considering Firestone for some time, and Sony and CBS Records had a long-established joint venture in Japan. But the move by Nippon Mining, an obscure mineral and petroleum refining company, on a well-known Illinois computer and electronics outfit threw the staid old Japanese electronics giants for a loop.

Nippon Mining bought Gould in order to diversify. Says Natori: "The big electronics companies—Sharp, Sanyo, Matsushita—all could have used Gould. They never thought of going after it." Now, he says, all are looking for good electronics acquisitions in the U.S. and Europe.

The change in attitude is most striking at Toyota and Matsushita ($27 billion between



*Figures for Japanese corporations represent parent company's assets only. Others are consolidated. †Net cash before $2.6 billion acquisition of Firestone, March 1988. ‡Net cash after $2 billion acquisition of CBS Records, November 1987. §Net cash before $345 million acquisition of Zotos International, September 1988.

ILLUSTRATION BY JOHN PIRMAN

them). For years top executives at both companies insisted that excess cash was an untouchable reserve for hard times. Then came some really hard times—the rapid appreciation of the yen against the dollar two years ago that put an extraordinary squeeze on Japanese profits. Both Toyota and Matsushita weathered the storm of *endaka* without drawing down reserves, though the interest income was a handy boost for the bottom line.

Though many auto analysts worry about worldwide overcapacity, Toyota still wants to expand. Says executive vice president Tsutomu Ohshima: "We do not think the growth of the automobile business has stopped." He says equity participations, joint ventures, and acquisitions are all possibilities. "If an acquisition looks right, we'll look at the candidates positively. We wouldn't like to refuse some food without even tasting it," he says with a laugh.

Lighting up another Peace cigarette, Ohshima continues: "Such an acquisition would be for the purpose of winning the survival race in the world automotive business, which is getting more and more heated. It's not that we want to beat General Motors, it's that we want to make sure they won't beat us."

JAMES LEDGER

A recruit from Bridgestone (right) checks a Firestone tire.

WHAT WILL Toyota buy? Ohshima refuses to speculate, but a fair guess is something in Europe, where Toyota cannot keep up with demand in some countries and is hampered by import restrictions in others. One rumored target is Porsche, the German sports car maker with a close-to-cultish following. Another possible move for Toyota would be an equity or production deal with a carmaker in Spain or Turkey. Outside the auto business, Toyota has already stuck its toe in electronics, communications, and aircraft service and sales; further purchases in these areas have to be considered safe bets.

Matsushita admits that it missed the boat by not investing heavily in computers. The giant company, with $38.6 billion in sales last year, feels it can no longer look forward to a robust future on the strength of its videocassette recorders, washing machines, and toaster ovens. Says Jun Honda, a corporate finance manager: "We want to become a worldwide, comprehensive electronics company rather than just a Japanese appliance manufacturer. We have to consider mergers and acquisitions to get there." He says that the company is finally breaking out of its engineering mind-set, realizing that it can no longer insist on building and designing everything itself. Says Honda: "We are a huge business, but we do lack technology in a number of areas." Matsushita wants to buy companies—and employees—with expertise in office automation, factory automation, computer networks, and custom memory chips.

Hitachi plans to increase spending for R&D and build more plants overseas, but like Matsushita the company also hopes to acquire foreign brain power. Says Yasuo Miyauchi, Hitachi's crusty executive vice president: "In some of our areas we are not so good at what we do. We are not the leading company." His goal is to make Hitachi as big or bigger than IBM or GE. "M&A is at the top of our list," he says. In computers and telecommunications, for example, Hitachi still distributes its products through Olivetti in Europe and National Advanced Systems in the U.S. Eventually Hitachi would like to build and sell its own brand of computers in the U.S. and Europe. Says Miyauchi: "To develop all that, we need more human resources."

Toshiba's wish list? Says Nobuyuki Horiuchi, general manager for finance: "We're interested in companies in a promising or growing business. Computers, integrated circuits, medical equipment, telecommunications, ceramics, superconductivity, are some fields we are looking at. Our range is from the tiny to the huge." Like Hitachi, Toshiba plans to expand its overseas production sites, but sees acquisitions as a good way to grow.

continued

WISH LISTS: WHAT JAPANESE COMPANIES WANT

TOYOTA	Matsushita Electric	HITACHI	TOSHIBA	Nippon Oil
Build new factories around the world. Diversify through acquisitions in electronics, telecommunications, factory automation, and possibly aerospace. Buy into or create joint ventures with other automakers, most likely in Europe.	Buy foreign software companies, particularly those involved in office automation, factory automation, and computer networks. Build more overseas plants.	Expand production around the world. Buy foreign computer and telecommunications companies that have global sales and distribution networks.	Buy foreign companies that have strong positions in computers, integrated circuits, medical equipment, telecommunications, ceramics, and superconductivity. Build more plants throughout the world.	Become a major global oil producer by buying proven oil reserves anywhere in the world, or foreign oil companies that have big reserves.

At Nippon Oil, Japan's largest petroleum importer, refiner, and marketer, you have to hunt for Mamoru Sugiyama, a director and head of finance. There is no receptionist in his part of the gloomy Nippon Oil headquarters in central Tokyo. Once found, however, he cheerfully insists that FORTUNE's list understates his company's wealth. He reckons Nippon Oil has $4.6 billion on hand. Half of that, about $2.3 billion, is currently earmarked for achieving the company's goal of becoming a diversified international oil company. The plan is simple: Nippon Oil wants to buy oil reserves, either in the ground or through acquisitions of companies with large reserves.

SOME CASH-RICH companies will use their money to get out of mature businesses into new fields. Matsushita Electric Works, an electronic-parts spinoff of Matsushita, is a prime example. Since nearly 70% of the parts it makes can be produced more cheaply in South Korea or Taiwan, the company is on the lookout for acquisitions and joint ventures, chiefly in computer networks and artificial intelligence.

Sanyo is branching out too. One of Japan's older electronics companies, it lost $130 million last year on sales of $8.8 billion. It has a product mix that is too dependent on the audio, video, and home appliance markets and has yawning gaps in such fast-growing areas as personal computers and telecommunications equipment. In an effort to catch up, Sanyo doubled research and development spending last year to nearly 4.5% of sales, set up a new business development unit, and is on the lookout for acquisitions both at home and in the U.S.

What kind of acquisitions? Says executive vice president Yasuaki Takano: "It's time for Japan to think about leisure time. Before, we thought only about electric appliances, but now we're thinking about our quality of life." As a first step, Sanyo has set up a venture with Misawa Homes, a leading residential builder in Japan, to work out designs for a house of the future. The company is looking for a large tract of land to build its dream houses. Though the Japanese have never been particularly known for gracious homes, Takano hopes to develop the new business on a global scale. "This will be a big pillar for future development of this company," he says confidently.

Japanese companies are also interested in buying affection. Charity, once considered *kankei-nai*—no relation—to Japanese companies, is now big business. Says a board member of one of the richest companies: "Our donations are going to be way up around the world." Then he adds, "Please don't print our name. If our name appeared, we'd be swamped."

Toyota's Ohshima sums up the position of Japan's super-rich with endearing frankness: "Japanese companies, I think, viewed corporate responsibility as something to fulfill by making quality products at low prices. Unlike the U.S., where there is a large gap between the wealthy and the poor, we are a homogeneous society. As a result, the Japanese have been slow in acquiring the philosophy that the rich must help the poor. When it comes to contribut-

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ing to a better world, Japanese companies have good intentions but don't know how to best fulfill them. We are still groping for the answer."

TOYOTA has already made one change. "We used to give away money anonymously," says Ohshima. "Now the feeling is, if you are going to donate you must make it public, otherwise it's not worth it." Toyota now gladly reports that its charitable donations increased fourfold in the year ended June 30, to around $55 million. The emphasis was heavily on academic scholarships and endowments. General Motors last year gave away $57.3 million.

Matsushita unveiled a $25 million foundation in January, also weighted toward educational exchanges. Says Toshihiko Yamashita, former president and currently an adviser to Matsushita: "Japan is now a leading economic power in the world. It is time for us to act as a leading nation." Toshiba says its requests for money already make a five-foot stack. The company is developing a system of priorities. Adds Hitachi's Miyauchi: "We are one of the biggest companies in the world. We'd like to increase our charitable work. We should do it."

This brand of charity also involves a fair amount of self-interest. The Japanese want to smooth over any nasty ripples following big acquisitions or plant investments. Says Yoshio Nakamura, senior assistant director of international economic affairs of the Keidanren, Japan's premier business association: "If we don't pay attention to community relations in the U.S., we will lose a key factor in success."

At the moment government tax breaks for donations are lower than elsewhere, with around 1.25% of pretax income deductible. Japanese tax law is unclear on whether overseas giving can be included in the deductible amount. The ministry for international trade and industry (MITI) is trying to get the ministry of finance to rule in favor of such deductions. If MITI succeeds, that should lead to a sharp increase in the number of Japanese bearing gifts abroad.

One thing rich Japanese companies do not worry about is being taken over by someone else. In the U.S. an underperforming cash-laden company like Sanyo would be a takeover target. Says John Connolly, chief investment strategist for Dean Witter: "On Wall Street nothing attracts a shark like green money or the red meat of losses." But in Japan about two-thirds of a company's shares are held by its bankers, customers, suppliers, and other friendly investors. "The individual shareholder is pretty far down the list of priorities in Japan," says the Harvard business school's Kester. Natori of the Industrial Bank of Japan agrees: "We don't have Western, America-style capitalism here. The company isn't just responsible to its shareholders, but rather to all its concerned parties." Matsushita's Honda says almost emotionally, "The life of a corporation should be eternal."

Will the Japanese continue to think that way? For now, it looks as if they will. But one Japanese top executive admits that he would like to adopt one American-style business practice—nicer offices. And maybe an extra pencil.

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